Two for 242: Federal mortgage insurance used two different ways helps hospitals improve services and reputations

By Bill Wilson, Senior Vice President, Lancaster Pollard

Doctors at St. Mark's Medical Center in Texas suspected appendicitis in a man admitted opening day. Confirming the diagnosis could have taken hours at the hospital St. Mark's replaced, leaving the patient in a holding pattern as doctors digitized a diagnostic image, sent it electronically to an Austin hospital and awaited an interpretation. But with the new digital CT scanner St. Mark's purchased -- using funds made available by a federally-insured mortgage -- the diagnosis took only minutes.


Courtesy Perkins & Will Architects

St. Mark's opened its doors July 11. The new facility and its new equipment were financed through the Federal Housing Administration's Section 242 mortgage insurance program. More than 1,300 miles north in Ohio, Bucyrus Community Hospital is using the same loan program to battle an image problem. Community residents were willing to drive more than 60 miles for what they perceived as more advanced care, despite the Critical Access Hospital's proven capabilities. This summer, Bucyrus Community Hospital completed a $26 million financing that will transform its 95-year-old building into a modern, spacious community asset with new operating rooms and a new oncology ward.

The community is proud and excited about the renovations, Bucyrus Chief Executive Officer Gerard Klein said. "Twenty-one months of construction will really bring us to state-of-the-art health care and [will] sustain us for decades to come."

The two hospitals' uses of a federal mortgage insurance program illustrate the Department of Housing and Urban Development's gradual breakout from a geographical niche market. The effort has expanded uses of the FHA Section 242 program to revamp and revitalize older hospitals and build new ones nationwide. The program puts the full strength of the government behind hospitals that have more difficulty accessing capital because of their financial strength or other circumstances. The federal insurance allows them to issue higher-rated bonds with lower interest rates that reduce the long-term cost of borrowing.

"Historically the program was principally centered in the northeast, particularly in New York," said William Tan, director of HUD's Division of Facilities and Loans. The state's payment system created a demand for the insurance program, Tan said. "We saw at one point approximately 80 to 85 percent of the volume of the portfolio [was] from hospitals in the state of New York."

In the last five years, however, the program has made a concerted effort to diversify its portfolio both geographically and in terms of hospital size. Thirty-three hospitals in 16 states have used the program since 2001.

The changing economy also has contributed to interest in the mortgage insurance program. Hospitals that may formerly have qualified on their own to issue mid- to high-rated bonds have found themselves with tighter financial constraints in the face of rising health care costs and changing Medicare reimbursement policies.

"We've had interest and approvals throughout the nation -- as the song says, 'from the redwood forest [to the Gulf Stream waters],'" Tan said. "It's renovations, modernization, new construction, expansion. We have examples of each of them."

The underwriting criteria and program flexibility made the program the only viable option for St. Mark's and Bucyrus, two very different undertakings with the same goals.

St. Mark’s replaced Fayette Memorial Hospital, a 1960s-era building that did not enjoy a strong reputation in the area and had a hard time recruiting physicians. But St. Mark’s has the potential to become a regional health center, Chief Executive Officer Kelley Oliphint said, and already its impact has been dramatic.

Expanding Fayette Memorial Hospital was not possible; the property, like many in small towns, was landlocked. St. Mark’s credit profile was not strong enough to access traditional financing or private credit enhancement. Borrowing without an enhancement would have resulted in prohibitively high interest rates, and getting financial help by partnering with a for-profit health system was rejected because the community wanted the hospital to remain independent.

“From a financial standpoint, while we were doing well, people don’t want to back something that’s just been going pretty well for two years,” Oliphint said. “And while I felt that certainly we were going to do well in the future, it’s hard to convince someone who’s going to give you a ton of money.” The 242 program was the most cost-effective option for building a new hospital.

Financing under historically low interest rates, St. Mark’s ended up with more money than it thought possible. It replaced old equipment rather than moving it from Fayette Memorial. Demand for diagnostic imaging was up 40 percent for CT scans and 66 percent for MRIs in the first month of business, Oliphint said, and physician referrals already are higher than they ever had been prior to the financing.

Physician recruitment also has become easier, Oliphint said, with two OB/GYNs and a general surgeon recently joining the team and local doctors electing to stay in the area. “We’ve brought pediatricians and general physicians back home where they grew up,” he said. A new medical office building is preparing to build next door, and the hospital has spurred housing developer interest.

The decision whether to renovate or build new can be complicated by funding options. The 242 program allowed both and provided additional value to the borrowers, though the option does involve a lengthy federal application and approval process. The decision by St. Mark’s to build new added land purchase and fundraising concerns, while Bucyrus was challenged with bringing an old building up to code and adding services within a limited footprint.

The 242 program is appropriate for and creates opportunities for both build on and build new projects. If community hospitals are looking at similar projects and are unlikely to achieve investment-grade ratings, this option lets them maximize borrowing ability.

While building a new hospital offers the opportunity to start from scratch, the increased project scope may require an additional equity contribution. A renovating hospital such as Bucyrus may include existing buildings and equipment in its project value, maximizing the loan amount because the 242 program offers loans up to 90 percent of the project value. New hospitals such as St. Mark's, however, can count only the equipment that will be transferred to the new site in their project values, and they may incur site development costs that cannot be funded by the 242 program. Although each project was approximately $25 million, Bucyrus’ equity contribution was one-fourth that of St. Mark's.

The Bucyrus community was heavily invested in its existing facility, having contributed to previous hospital improvement projects. In addition, leaders determined that the additional expense of building new, with the time and land purchasing considerations, would have been too much. The cost-conscious hospital found a bonus in the 242 program: contractor guaranteed maximum prices. Once a price was set, the hospital knew it would not have to pay any additional fees for contingencies.

Bucyrus Community Hospital was the first in Ohio to use the 242 program. It took advantage of special underwriting criteria for Critical Access Hospitals, which receive full Medicare reimbursement in recognition of their essential places in rural communities. The hospital was allowed to recast some of its financial statements to achieve the financial ratios that qualified it for the mortgage insurance.

“Our options were very thin,” Klein said. “The most likely option [without 242] is we wouldn’t have been able to proceed.” Another possibility would have been to break the master plan into smaller projects, he said, a choice that dealt with piecemeal problems rather than true structural issues.

Bucyrus broke ground in July on 50,000 square feet of additions. The funding also will relocate the 25-bed hospital’s heliport, expand the oncology ward and build a new restaurant and community meeting space.


Courtesy Collins Gordon Bostwick Architects

Klein said he is confident that the renovations will reestablish a strong reputation that matches the hospitals’ commitment to the community. Increased options for ambulatory surgery and more attractive surgical suites should appeal to physicians, he said, and the new oncology ward, ICU, emergency department and ambulatory unit are designed to meet the community’s changing needs for decades to come.

“When you see such a significant modernization going on,” he said, “…that represents progress for not only the hospital, but for the community.”